

FY 2006

FEDERAL, STATE AND LOCAL
GOVERNMENTS

WORK PLAN

October 1, 2005

FY 2006 FSLG Work Plan

TELEPHONE CONTACTS

Area	Contact	Telephone
General Questions	Sunita B. Lough Stephen E. Wharton	(202) 283-9818 (202) 283-9799
Customer Education and Outreach	Stephen E. Wharton Stewart Rouleau	(202) 283-9799 (202) 283-9794
Examinations	Stephen E. Wharton William Reed	(202) 283-9799 (202) 283-9747
Research Plan	Terry Rodriguez	(954) 423-7156
Training	Norma J. Steele	(202) 283-9805
Form 5440 for FSLG	Stephen E. Wharton Terry Rodriguez	(202) 283-9799 (954) 423-7156

TABLE OF CONTENTS

Topic	Page
Executive Summary	3
Planning Process	
Overview of FSLG	6
Methodology	7
Work Plan Areas	
BAC 52, PAC TT	9
Customer Education and Outreach	9
Stakeholder Relationship Management	10
Other Actions	10
Performance Measures	10
BAC 64, PAC EF	11
Expand FSLG Compliance Enforcement Activity	11
Federal Agency Compliance	12
Large Entity Compliance	12
Tin Matching for Federal Agency Vendors	12
Abusive Tax Avoidance Transactions.	12
Build a Highly Qualified and Satisfied Work Force	12
Performance Measures	12
Appendices	
Appendix A: Training	13
Appendix B: Compliance Plan	14
Appendix C: Research Plan	20
Appendix D: Form 5440	24

Executive Summary

The Office of Federal, State and Local Governments (FSLG) supports the Internal Revenue Service (IRS) and the Tax Exempt and Government Entities (TEGE) Division strategic goals of:

- 1) Enhancing Enforcement of the Tax Law; and
- 2) Modernizing the IRS through its People, Processes and Technology.

In support of these goals, FSLG has committed to the following Work Plan Areas:

- Expand FSLG Compliance Enforcement Activity,
- Continue the Federal Agency compliance initiative that began in FY 2005,
- Continue the Large Entity compliance initiative that began in FY 2005,
- Begin an initiative to address Tin Matching for Federal Agency Vendors,
- Address Abusive Tax Avoidance Transactions (ATATs),
- Build a Highly Qualified and Satisfied Work Force,
- Understand and Improve Compliance,
- Meet Customer Needs,
- Improve Organizational Performance, and
- Improve Knowledge and Information Management

A central theme in the FY 2006 Work Plan is FSLG's focus on expanding compliance enforcement activity. Specifically, FSLG is committed to continuing its Federal Agency and Large Entity compliance initiatives that began in FY 2005.

In FY 2005, FSLG committed to addressing compliance by Federal agencies with Federal tax laws. The compliance plan included the formation of a dedicated Federal agency compliance group in September, 2005.

Noncompliance by Federal agencies with applicable tax laws has been identified as a concern by the General Accounting Office (GAO), Treasury Inspector General for Tax Administration (TIGTA), and the Office of Management and Budget (OMB), Congress, and by the IRS itself in various internal documents. Both OMB and GAO have recommended that the IRS establish a program to conduct examinations on each Federal agency on a recurring cycle every 3-6 years.

In FY 2005, FSLG also committed to implementing a compliance program that addresses large non-Federal government taxpayers. These taxpayers, with annual payrolls in excess of \$40 million, have generally never been examined and are large enough to have significant impacts on the Social Security and Medicare trust funds. These taxpayers employ over 80% of all non-Federal government employees. These FSLG compliance initiatives are the first steps designed to systematically review Federal Agency and large entity compliance.

Based upon the results of the Federal Agency examinations conducted in FY 2005, FSLG will continue to:

- Refine case selection criteria based on FY 2005 experience,
- Evaluate need for resources based on FY 2005 experience,
- Commence 16 examinations and complete at least 6,
- Continue to refine processes for Federal agency examinations,
- Initiate team audits on larger Federal agencies,
- Refine audit procedures, and determine appropriate changes to baselines, and
- Plan outreach activities based on results.

Based upon the results of the large entity examinations conducted in FY 2005, FSLG will continue to:

- Refine case selection criteria based on FY 2005 experience,
- Commence 25 examinations and complete at least 15,
- Continue to refine processes for agency examinations,
- Increase team audits on larger governments,
- Evaluate need for resources based on FY 2005 experience, continue to refine procedures, and determine appropriate changes to baselines, and
- Plan outreach activities based on results.

FSLG will also begin an initiative to address Tin Matching for Federal Agency Vendors. A recent report by the GAO found that about \$5 billion in payments to 152,000 payees made during 2000 and 2001 by agencies within three Federal departments were not reported to the IRS. About 8,000 of these payees had received \$421 million in payments, yet had failed to file tax returns for these years. In addition, about \$20 billion in payments that were reported to the IRS on 170,000 information returns for 2000 and 2001 included invalid vendor TINs.

FSLG supports the IRS wide effort to identify and eliminate ATATs. We will incorporate steps to identify customer participation in abusive schemes. Our customer base is primarily tax-neutral enablers of some schemes. Our efforts will include developing information for use in educational programs as well as providing guidance to our compliance personnel.

We will continue to address key areas of noncompliance through a combination of targeted outreach, development of new educational products, and various field compliance activities. While focus will be placed on the national and regional issues identified through research, environmental scanning, and other means, activities to address significant local issues will also be supported.

FSLG will use the employee survey to identify opportunities for improvements in employee satisfaction. We will continue to involve managers and employees in improvement processes for FSLG and train our workforce to ensure that employees have the skills necessary to meet customer needs.

PLANNING PROCESS

OVERVIEW OF FSLG

The office of Federal, State and Local Governments is responsible for federal tax administration issues relating to 87,000 plus governmental units and their subordinate agencies in the United States. Issues addressed include employment taxes, excise taxes, and information reporting. FSLG is also responsible for ensuring compliance with and assisting in the administration of FICA coverage agreements under the provisions of Section 218 of the Social Security Act.

At the start of FY 2006, FSLG will be staffed at 100% of planned staffing. This will be the first year FSLG has met its initial staffing footprint established in FY 2000. As a result of attrition, FSLG projects that it will complete FY 2006 at 97% of planned staffing. Projected attrition is not anticipated to have any impact on FSLG's ability to meet customer needs and its primary goals for FY 2006.

Our primary goals for FY 2006 include continued expansion of our compliance efforts and maximizing our educational efforts. In FY 2006, FSLG will continue to maintain an effective balance between traditional compliance work and educational activities. Compliance activities will again be a major focus for all field groups.

FSLG continues to develop an annual comprehensive compliance plan involving managers, field specialists and OPR staff. This compliance plan is incorporated into the FSLG Annual Work Plan. Responsibility for the development of the Annual Work Plan is vested with the Manager, Outreach, Planning, and Review.

FSLG's interaction with its customer base affects compliance levels of the governmental employers and their 23 million employees. These entities employ 20% of the American workforce, pay wages in excess of \$760 billion annually and pay employment taxes in excess of \$200 billion. (This is the largest block of employees in the U.S.) Governments also buy goods and services of more than \$2.5 trillion and have an economic impact of over \$3 trillion annually (this represents 20 percent of the US economy) and have assets in excess of \$16 trillion.

METHODOLOGY

Trends, Issues, and Problems (TIPs) were identified in the Strategic Business Plan for FY 2006 at the time of its formulation. The FSLG office involved the field specialists, managers, and OPR staff in the development of the work plan.

The foundation for the formulation of the FY 2006 FSLG Work Plan is based on the TIP areas, but refined to specific issues through the analysis of IRS data, customer input, employee input, and our environmental scan of our employees. These issues form the basis for the compliance activities to be undertaken in FY 2006. The major areas of emphasis are: Examinations, Compliance Checks, and Information Reporting Compliance.

The employment tax field in general and the governmental sector in particular, have not been the subject of significant research activity or information gathering at the Service level. Governments generally only file information returns and employment tax returns. There are no additional returns to provide compliance indicators, thus classification avenues are limited. An additional complicating factor is the ability of governments to file “consolidated” employment tax returns, a process unavailable to any other group of employers in the country.

This lack of basic information has been considered in developing the FSLG compliance workload selection process. FSLG has considered anecdotal evidence, customer contact data, and our employee environmental scan in developing our examination plans for FY 2006-2007. We are improving the process for future years. To accomplish this, we:

- Developed a formal workload selection plan to ensure consistency and impartiality in our exam process;
- Included workload selection and risk analysis in our fy 2005-2007 research plan;
- Will work a sample of cases in several market segments in fy 2006 to determine compliance levels and identify significant issues;
- Evaluate the results of market segment audits beginning in 3q fy 2005; and
- Continue employee participation in our workload classification.

WORK PLAN AREAS

FSLG will support the TEGE Division major strategies and operating priorities for FY 2006. These strategies address key challenges we face in delivering top quality service to customers, and productivity through a quality work environment. These include actions to:

- Understand and Improve Compliance FSLG will continue to utilize employee input, customer feedback, data analysis, and environmental scanning, to secure a comprehensive knowledge of key compliance issues and causes of noncompliance.
- Meet Customer Needs FSLG will work closely with customers through the Newsletter, educational products and Customer Satisfaction survey analysis to ascertain their needs, as well as to design and deliver mutually agreeable remedies to identified compliance concerns and problems whenever possible.
- Improve Organizational Performance FSLG will utilize balanced measures and analyze the results to effect operational enhancements to improve performance.
- Improve Knowledge and Information Management FSLG will expand its gathering and use of data, and fully develop database tools to improve our abilities to identify, track, and measure the impact of all field activities. FSLG will fully implement knowledge sharing groups within FSLG. We will continue to support the development and implementations of TREES as the TE/GE work-center with implementation training planned for the 3rd and 4th quarters of FY 2006.
- Expand FSLG Enforcement Activity FSLG will increase compliance enforcement activities to 88% of available direct time in FY 2006.
- Continue to address Federal Agency compliance FSLG will continue examinations of Federal Agencies during FY 2006.
- Continue the Large Entity Compliance Programs for Governments with Payrolls in excess of \$40 Million FSLG will continue examinations of larger entities during FY 2006. This continues a shift in emphasis from smaller governments to a more inclusive mixture of work that reflects customer issues and expanding employee expertise.
- Begin an initiative to address Tin Matching for Federal Agency Vendors FSLG will begin an initiative to address Federal Agencies that file information returns with mismatched, unassigned, or otherwise invalid TINs.
- Address Abusive Tax Avoidance Transactions FSLG will incorporate steps to identify customer participation in abusive schemes. Our customer base is primarily tax-neutral enablers of some schemes. Our efforts will include developing information for use in educational programs as well as providing guidance to our compliance personnel.
- Build a Highly Qualified and Satisfied Work Force FSLG will continue to train its workforce to ensure that employees have the skills necessary to

meet customer needs. We will continue our use of the employee survey to identify opportunities for improvements in employee satisfaction. We will continue to involve managers and employees in improvement processes for FSLG.

BUDGET ACTIVITY CODE 52, PAC TT

These codes correspond to the resources devoted to Pre-filing Education and Assistance, which includes customer education and outreach, direct and indirect assistance, and coordination of assistance actions between FSLG and other functions.

Customer Education and Outreach

FSLG will address key areas of noncompliance through a combination of targeted outreach, development of new educational products, and various field compliance activities. While focus will be placed on the national and regional issues identified through research, environmental scanning, and other means. Activities to address significant local issues will also be supported.

Emphasis in delivery of outreach and educational activities should be placed on quality events that provide topical, relevant information to our customers. Events should be planned considering the message to be delivered, the audience size, and the cost/benefit to be derived from the event. As a general rule, we should not plan events that:

- Introduce FSLG to the audience absent additional educational purposes;
- Have fewer than 10 participants without prior approval;
- Serve minimal educational purposes.

Convention participation involving display booths and similar activities should be limited to significant events. Although these events create a public awareness of FSLG within our target audiences, they do not generally deliver an actual educational benefit to the customer. These events should be planned prior to the beginning of the Fiscal Year. Consideration should be given to:

- The target audience;
- Cost of delivery, including booth rentals;
- Benefit to be derived; and
- Frequency of participation.

Each group should plan activities to support outreach/education aspects of:

- Federal Agency Compliance (limited to the Federal Agency group with assistance as requested);
- State and Local Government Compliance with a commitment to education activities directed at both large and small governments;
- Information Returns Reporting.

FSLG will undertake these efforts with governmental entities at the Federal, State and Local levels.

FSLG will also continue to upgrade its portion of the www.irs.gov web site.

Stakeholder Relationship Management

We will continue to partner with the Social Security Administration as our most important stakeholder while maintaining and increasing our actions with other stakeholders. Stakeholders will be involved in the development of outreach products and in efforts to maximize the benefit of customer education efforts.

Other Actions

Balanced Measures - FSLG will continue to utilize Balanced Measures to determine Employee Satisfaction, Customer Satisfaction, and Business Results. Results of these measures will assist FSLG in ensuring that actions undertaken do not adversely impact any of the three areas/aspects, and will assist FSLG in identifying areas in need of operational improvements in subsequent years.

As part of this process, FSLG will continue the structured review of all examinations and compliance checks, and in FY 2006 will implement reviews of outreach activities.

FSLG will also initiate use of examination cycle time as a performance indicator in FY 2006.

The FSLG measures being utilized for Employee Satisfaction and Business Results are generally consistent with measures used by other functions. The FSLG Customer Satisfaction Survey for outreach has shown a high degree of customer satisfaction with the content and delivery of our educational programs. FSLG will work to keep the customer satisfaction at current levels during FY 2006.

Performance Measures

The following performance indicators will be used in FY 2006 for assessing Budget Activity Code 52, PAC TT activities:

Federal State & Local Governments	FY 2005 Plan	FY 2006 Plan
Number of Outreach Events	315	293
Number of Customers Reached	14,200	14,200

BUDGET ACTIVITY CODE 64, PAC EF

This area represents the resources devoted to Field Compliance Services, including compliance checks, return examinations, research projects, and requisite support work.

Workload Selection

FSLG will continue to refine the workload selection criteria utilized in prior years. In addition, FSLG will partner with Exempt Organizations and Employee Plans to coordinate workload identification where our customers overlap.

Workload selection will be monitored to ensure that key areas identified through environmental scanning, research, and other means are addressed, and that the actions being assigned represent the optimal approach to the identified issue. FSLG will continue to undertake Compliance Checks as a mechanism to provide broad-based compliance coverage, to identify customer needs and to foster self-correction. FSLG will also conduct examinations as necessary.

Research

FSLG will continue implementation of the FY 2006-2008 FSLG Research Plan and annual analysis of federal tax compliance. During FY 2006, the research plan will be revised and expanded to identify opportunities for improvement in the FY 2006-2007 time frame.

Compliance Focus Areas

FSLG field compliance workload will focus on the following key areas:

Expand FSLG Compliance Enforcement Activity

1. Examinations

FSLG examinations of books and records relating to the determination of a tax liability will generally address employment tax issues, Social Security Act Section 218 compliance issues, information return issues, FICA replacement plan issues, Section 115, Abusive Tax Avoidance Transactions and other priority work. Examinations will generally be limited to the most current year. Expansion to other years will occur in appropriate situations with written managerial approval.

Claim examinations, including Medical Resident Claims will continue to constitute a significant portion of our examination workload for FY 2006. Field groups will prioritize claim work while maintaining an active non-claim examination program.

2. Information Reporting

FSLG will work with governments to improve information reporting at all levels of government. Reporting compliance in the proper filing of Forms 1099 and W-2G will be addressed through field compliance actions, including compliance checks and examinations.

Federal Agency Tax Law Compliance

FSLG will continue its Federal Agency compliance initiative that began in FY 2005. Based on the results of the examinations conducted in FY 2005, FSLG will continue to:

- Refine case selection criteria based on FY 2005 experience,
- Evaluate need for resources based on FY 2005 experience,
- Commence 16 examinations and complete at least 6,
- Continue to refine processes for Federal agency examinations,
- Initiate team audits on larger Federal agencies,
- Refine audit procedures, and determine appropriate changes to baselines,
- Plan outreach activities based on results.

Large Entity Tax Law Compliance

FSLG will continue its Large Entity compliance initiative that began in FY 2005. Based on the results of the examinations conducted in FY 2005, FSLG will continue to:

- Refine case selection criteria based on FY 2005 experience,
- Commence 25 examinations and complete at least 15,
- Continue to refine processes for agency examinations,
- Increase team audits on larger governments,
- Evaluate need for resources based on FY 2005 experience, continue to refine procedures, and determine appropriate changes to baselines
- Plan outreach activities based on results.

Tin Matching for Federal Agency Vendors

FSLG will begin an initiative to address Federal Agencies that file information returns with mismatched, unassigned, or otherwise invalid TINs.

Build a Highly Qualified and Satisfied Workforce FSLG will continue our use of the employee survey to identify opportunities for improvements in employee satisfaction. We will continue to involve managers and employees in improvement processes for FSLG. As described below, FSLG will continue to train its workforce to ensure that employees have the skills necessary to meet customer needs.

Performance Measures

The following performance indicators will be used in FY 2006 for assessing Budget Activity Code 64, PAC EF:

Federal State & Local Governments	FY 2005 Plan	FY 2006 Plan
Examinations Closed	1,080	1,430
Compliance Checks Closed	750	825
Examination Timeliness	250	238
Examination Quality	76%	77%

Appendix A

TRAINING

The following items are descriptions of FSLG training courses:

Course 10036: Continuing Professional Education (CAS)

FSLG will provide two instructors to support the CAS CPE.

Course 10055: Continuing Professional Education – FSLG

Continuing education to maintain and enhance professional skills, The class will be provided to all field specialists and selected OPR staff.

Course: TREES

This training will provide Work Center training for all FSLG employees.

Course 11219: TREES Change Management

This course will provide TREES implementation training for FSLG Director.

Course 11269: Medical Resident FICA Claims Training

This training will provide guidance to FSLG examination personnel in handling FICA refund claims and related issues with respect to medical residents.

Course 15355: Analytical Skills: Improving Performance Through Data Driven Decision Making

Training will be conducted for 8 analysts.

Course 17590: Abusive Tax Avoidance Transaction Training for FSLG

This course will provide basic awareness training on ATATs for all FSLG employees.

Course: Federal Agency Audits

This training will provide guidance to FSLG examination personnel in handling the issues that surround the audits of federal agencies. Training will be provided to 20 employees.

Course: Large Entity Audits

This training will provide guidance to FSLG examination personnel in handling the issues that surround the audits of large entities. Training will be provided to 20 employees.

Appendix B

FSLG 2006 COMPLIANCE PLAN

INTRODUCTION

Since the IRS assumed responsibility for governmental entities in 1987, most of its customers have not been subject to any type of compliance activity. FSLG's recent compliance efforts signal its intention to build trust in the fairness and integrity of the tax system in the government sector. This FY 2006 compliance plan will continue to focus on areas where FSLG can most effectively apply its compliance resources to meet organizational goals.

In the first years of FSLG's existence, FSLG focused primarily on outreach and education to governmental customers. In FY 2004, outreach activities were reduced from 60% of available FSLG resources to 25%. Compliance activities increased to 75% of available resources. For FY 2005, the ratio was 80% Compliance and 20% Outreach. The increased focus on compliance continues into FY 2006 where the ratio will be 85% Compliance and 15% Outreach.

Compliance activities include general examinations and examinations of refund claims as well as compliance checks of entities for 1099 reporting compliance, non-filing conditions, and balance due accounts. In response to numerous Government Accountability Office (GAO), Treasury Inspector General for Tax Administration (TIGTA) and Office of Management and Budget (OMB) reports indicating widespread and longstanding Federal agency non-compliance, FSLG established a group dedicated exclusively to working Federal agencies during FY 2005.

OBJECTIVES FOR FISCAL YEAR 2006

For 2006, the FSLG Business Plan calls for increasing Federal agency compliance via examinations and compliance checks. In addition, we will be auditing large entities. These will be our two major strategies for FY 2006.

The increased emphasis in compliance activities is designed to create a more balanced, effective, and informed program. The goals of this increased emphasis on compliance are to:

- Develop baselines for future actions;
- Establish a compliance presence in all of our market segments;
- Identify significant areas of compliance for future education and compliance activities;
- Identify significant issues for development of Service guidance;

- Determine the effectiveness of our educational efforts and their effects on compliance; and
- Identify abusive tax avoidance transactions that our customers may be facilitating.

The FY 2006 Workplan allocates 72% of direct time to compliance activities. These activities include:

Examinations of Federal Agencies:

These present the largest and most complex cases. Examinations in this sector will be based initially on specific non-compliance issues identified from sources such as GAO reports, SS-8 determinations, outreach/assistance efforts, and other sources. As noted in GAO Report 04-74, Federal agencies continue to exhibit significant non-compliance with information returns and backup withholding requirements. During FY 2006, FSLG will develop potential methods to address this issue. In the interim, each Federal examination will include a specific review of information returns and backup withholding compliance. The Director FSLG will approve all proposed Federal examinations prior to initiation.

Large Case Examinations

This is a nationwide strategy - each group across the country will be responsible for working a number of Large Case Examinations. These, too, will be time intensive cases and will often require the assignment of a team of specialists.

Regular examinations (other than claims)

FSLG is currently planning to close a total of 1430 returns across all segments in FY 2006.

Compliance checks

FSLG is currently planning on completing 825 compliance checks in FY 2006, covering all of our market segments.

CHALLENGES AND CONSIDERATIONS IN DEVELOPING THE COMPLIANCE PLAN

Determining the best use of the planned increase in compliance activities is a daunting challenge, made more so because of the lack of FSLG examination benchmarks and baselines.

In its first years of existence, FSLG was primarily involved in working claim cases. Now FSLG has some historical examination data, and continues to gather data in order to establish an accurate, statistically valid baseline for classification purposes. In order to develop both issue specific and compliance level baselines, FSLG will devote its resources equally to compliance sampling and analysis and to issue specific initiatives.

The Compliance Plan is developed through a cooperative process involving input from field group managers, specialists and the OPR staff. Field groups contribute to the plan by continuing to refer issues and information for consideration in the planning process. OPR utilizes the approved compliance plan and the supporting information to develop workload classification criteria for FSLG.

Because FSLG baseline data is currently insufficient to provide statistically valid input, FSLG is required to rely on currently available data in developing issues for audit consideration. These sources include:

- Anecdotal comments based on employee experience;
- Compliance check results;
- Outreach results;
- Filters developed by OPR;
- Our Environmental Scan survey;
- Referrals;
- GAO Reports, and
- Top Payers with TIN mismatch reports

Initial issues FSLG has identified include:

- Compliance with fringe benefits rules;
- Information return reporting;
- Worker classification.
- Federal agency information return reporting/TIN matching

EXAMINATION PLAN BY SECTOR

GENERAL

Compliance work will be determined by the FSLG workload selection system. All compliance work will originate in or be approved by OPR prior to initiation of the cases. Compliance selections will include large, medium and small entities. Much of our examination efforts in FY 2005 were directed towards hiring and training our 22 new specialists while trying to maintain a compliance presence.

Abusive Tax Avoidance Transactions (ATATs) FSLG customers that participate in ATATs may derive current revenue, not tax benefits from the transactions. As tax neutral third parties ('accommodation parties'), they are not normally concerned with the income tax effects of the transactions. In addition, there is a potential issue when our customers purchase retirement or health plans that are misrepresented as complying with the Internal Revenue Code when they do not, resulting in additional taxable wages for the participants. FSLG specialists will include an assessment and/or referral of potential ATAT issues in all examinations.

FSLG Large Case Program During FY 2006, FSLG will address a number of entities with annual payrolls in excess of \$40 million. These cases will be identified by OPR using RICS.

Uncertainty continues to surround resolution of medical resident claims. This uncertainty precludes specific planning objectives for these claims. However, all of the entities involved are larger examinations.

Information Returns Compliance (State and Local) Payments by FSLG customers represent a significant part of the national economy. When information returns are not issued, or use incorrect TINS, significant income amounts are not reported on tax returns. A GAO review of Federal agencies found significant compliance issues involving information reporting and back-up withholding. No similar study was done on non-Federal entities.

FSLG will examine a sample of non-Federal government units to determine the degree of compliance with information returns and back-up withholding requirements. These examinations will include employment tax issues; however, the main focus will be on information returns compliance. Each group will be assigned cases in this effort.

Federal Entities/Agencies These entities present the largest and most complex cases. Examinations in this sector will be based initially on specific non-compliance issues identified from sources such as GAO reports, SS-8

determinations, outreach/assistance efforts, and other sources. As noted in GAO Report 04-74, Federal agencies continue to exhibit significant non-compliance with information returns and backup withholding requirements. During FY 2006, FSLG will develop potential methods to address this issue. In the interim, each Federal examination will include a specific review of information returns and backup withholding compliance. These cases will be worked by the new group that has been established to address this market segment. The Director FSLG will approve proposed Federal examinations prior to initiation.

States/State Agencies These cases are potentially very large and complex, on a par with Federal entities. The challenge in this sector is to determine the number of filing entities in each state. State agencies and entities have been identified by the field and furnished to OPR. OPR will cross-reference this data with the BMF to determine the number of state entity filers. State level entities will then be identified for examination through the field referral process, third-party information, compliance issues developed in outreach/assistance efforts, and regular OPR examination selection criteria.

Local Governments These include all other entities. The complexity and size of these entities varies significantly.

The local government sector includes the following major segments: counties, cities/municipalities (further stratified by population, wages or other criteria), school districts, local hospitals/medical facilities, library boards, and special purpose districts.

This methodology ensures balanced examination coverage among all taxpayer segments and will assist in establish baseline compliance levels in these segments. Subsequent year compliance plans will be based in part on the compliance levels determined.

Coordinated/Support Examinations with Other TE/GE Subdivisions We are cooperating with Employee Plans (EP) in an examination program in FY 2006 to address Section 403(b)/457 retirement plans. We anticipate that each area will complete an examination in this program during FY 2006. EP will select the entities for examination, with input from FSLG area managers.

We expect that FSLG will provide employment tax examination support to Exempt Organizations in FY 2006 based on availability of resources. The number of examinations and potential time commitment is unknown at this time.

We receive referrals from EP and EO via the Specialist Referral System program as well as hard copy.

Compliance Checks Compliance checks planned for FY 2006 will primarily address non-filer entities and Form 1099 filing compliance issues and will generally encompass the smaller sized entities. These types of compliance

check cases may not directly translate into examination issues/ adjustments; however, field groups will be encouraged to recognize situations where a significant examination issue arises from a compliance check and to re-establish the case appropriately. Data regarding Issues found is being gathered for use in future compliance efforts.

FIVE YEAR EXAMINATION PLAN DEVELOPMENT

FSLG implemented a tracking system to track issues identified by market segment examinations at the beginning of FY 05. This information is being used to develop future compliance and outreach plans as well as to identify areas requiring additional guidance.

FSLG is matching the Census' Governments integrated Directory (GID) with the Business Master File (BMF) in a continuing effort to identify all of our customers and market segments. This will facilitate future workload selection/market segment analysis for FSLG, enabling classification activities by market segment and by filing information.

ACTIONS FOR FY 2006

As we compile data throughout FY 2006, FSLG will continue to develop the knowledge needed to better develop options to measure both the effectiveness of various compliance initiatives and the needs and current compliance levels of its customer base. Actions taken in FY 2006 should result in improvements in identifying issues for compliance plans for FY2007 and beyond.

Appendix C

RESEARCH PLAN

Purpose:

The purpose of the FSLG Research Plan is to identify (i) customers and their characteristics, and (ii) trends, issues and problems (TIPs) with regard to its customers. The Research Plan is necessary to meet the goals and objectives of the TE/GE Strategic and Program Plan as well as the FSLG Workplan. The Research Plan will also provide a basis for predicting taxpayer needs and compliance levels.

Information developed through research will allow FSLG to identify and analyze risk, educational gaps, and to develop trends and measurements. An ongoing research process is an essential component of our efforts to ensure compliance. The primary objectives of the Research Plan are to identify, quantify and monitor FSLG customers and their unique compliance issues. The major goals of the plan are as follows:

- To identify all government entity customers
- To identify trends, issues and problems of customers.
- To determine compliance risk levels

Scope:

The scope of the FSLG Research Plan is being set at a level that can be achieved using existing resources without adversely impacting FSLG major educational and compliance goals. The scope is determined by the goals to be achieved, the skill sets of available employees, and the level of support that FSLG is able to secure from TEGE Research.

Background:

The FSLG customer base of Form 941 filers comprises over 87,000 government entities. This figure does not include potentially thousands of sub-units that provide employment tax and information return reporting information for consolidation to a particular entity. Government entities employ approximately 20% of the workers in the US or 23 million government employees. They pay over \$775 billion annually in wages and employment taxes in excess of \$200 billion. The majority of these organizations are local government entities such as cities, counties, towns, school districts, etc. The governments also purchase

goods and services of more than \$2.9 trillion and have an economic impact representing 19% of the United States Gross Domestic Product.

II IDENTIFICATION OF CUSTOMERS

Objective:

To identify the universe of FSLG customers

Background:

FSLG has identified over 87,000 government entities through the IRS Business Master File (BMF). However, this figure does not include all of the sub-units that provide employment tax and information return information to the entity that files a consolidated Form 941 or has one Employer Identification Number. There are many larger government entities that comprise multiple operating units and are counted as a single entity while filing multiple returns or, conversely, entities filing a single return for multiple entities. For example, the U.S. Department of Agriculture National Finance Center processes payroll for a significant number of Federal agencies and files one return. It significantly understates the FSLG customer base when a single state may have as many as 250 sub-units or departments and the Federal government has over 300. These units report millions of dollars of wages and vendor/contractor payments through the “filing” entity.

FSLG has based initial customer identification on the Government Integrated Directory (GID) based on the Census of Governments conducted by the U.S. Bureau of the Census every five years. FSLG is also using IRS BMF records with employment codes F (Federal agencies), G (state and local governments) and T (state or local governments with Section 218 Agreements with the Social Security Administration) to identify return filings of its identified customer base.

While this methodology provided FSLG with its initial customer identification data, it contained significant flaws. These include:

- Some FSLG customers in BMF are not given an employment code of F, G or T customers and other entities that are not government entities are incorrectly coded as F, G or T.
- Significant sub-units of governments are identified as part of a larger organization. The need to reconcile the number of 941 filers (70,000) versus the numbers of Census identified governments (87,849)

Available Data Sources:

- Business Master File Entity records
- Bureau of Census database for 2002 Census of Governments
- Public Employer FICA Compliance Initiative (218 Initiative) data
- Information Returns data (RICS)
- TEGE Entity information from RICS
- Various internet sites listing governmental organization data

Resource Requirements:

- Assistance of TE/GE Research Office in developing criteria and ensuring statistical accuracy of the program.
- Appropriate computer systems support, including software, training and equipment.
- Adequate staff time (FTE) to develop this aspect of the program.

Milestones:

The principal task is to compare, contrast, and reconcile various sources to identify all government entities or significant sub-units for inclusion in the FSLG customer base. This will be an ongoing process due to new entities, mergers, and dissolutions. The major milestones to complete this task are as follows:

- Continue to work with the TE/GE Research Office to ensure that appropriate methodologies and processes are used in the completion of the research plan.
- Complete the matching process for the Census of Governments data
- Reestablish a working relationship with Census.
- Reconcile entities to determine proper classification?.
- Identify and correct errors in employment codes
- Identify significant sub-units through on-line research and other appropriate means.
- Identify and implement procedures to keep the database of customers current

III IDENTIFICATION OF TRENDS, ISSUES AND PROBLEMS (TIPs)**Objective:**

Identify customer trends, issues and problems to support TE/GE Strategic Program and Plan and the FSLG Workplan.

Background:

There is an ongoing need to develop TIPs for planning purposes. FSLG has been gathering information from various sources for this purpose. Some examples are the FSLG Environmental Scan Survey, customer outreach data, compliance checks, examinations, internal/external information items, etc. Including the information gathered from these sources in the Research Plan will allow FSLG to analyze the data and take actions to address the TIPs as part of the its annual planning process.

Available Data Sources:

- FSLG Environmental Scan
- FSLG Outreach Database
- Examination/Compliance Check Issue Tracking data
- Internal/External Information Reports
- Internet/Media Reports

Milestones:

- Centralization of data
- Analysis of current data
- Determine the risk of non-compliance by government taxpayers
- Identification of compliance issues suitable for targeted treatments